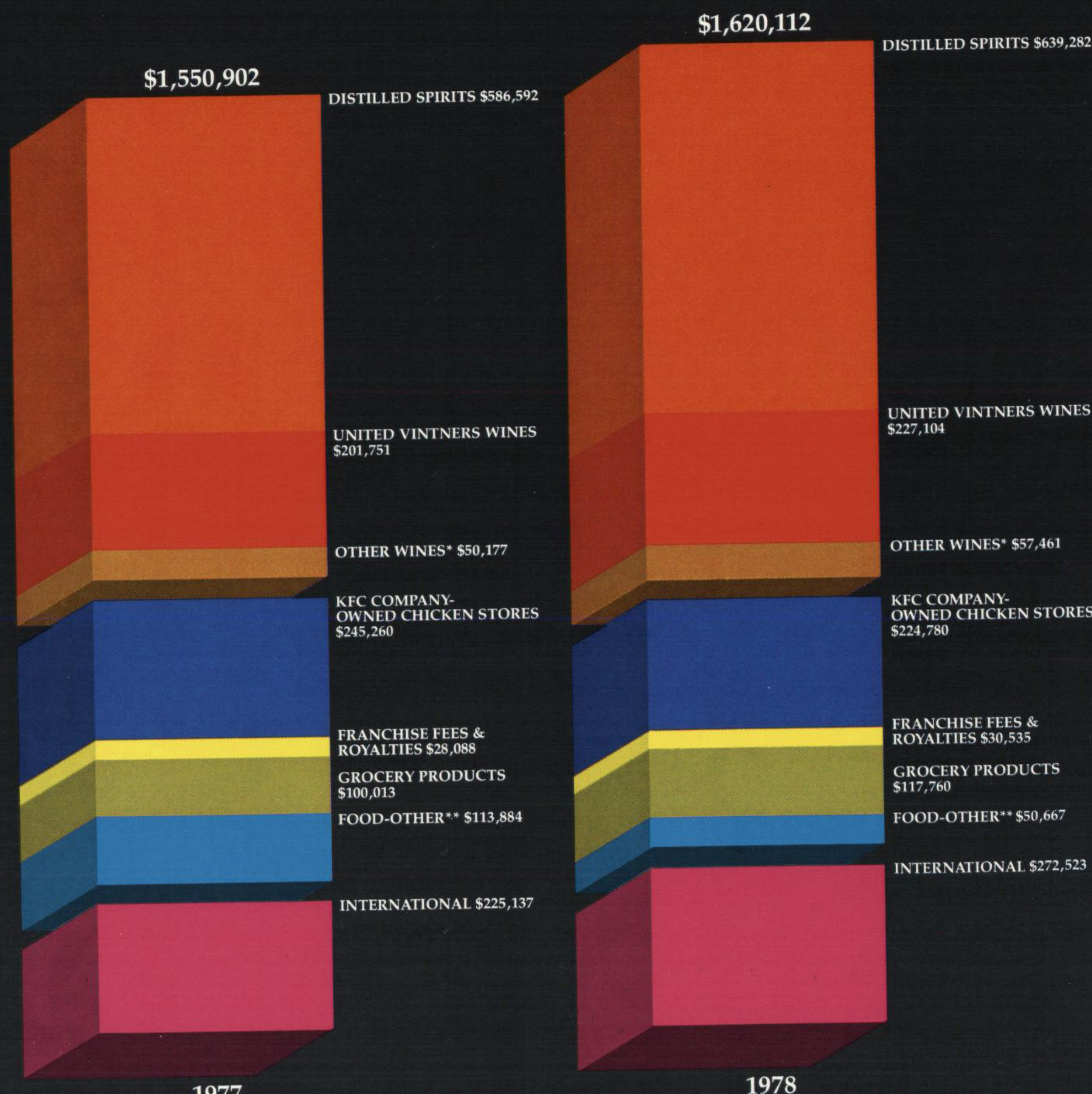
HEUBLEIN 1978 ANNUAL REPORT

An active, participative lifestyle clearly characterizes America today as Americans, in ever-increasing numbers, strive to keep fit.

Anticipating changing consumer behavior and serving it in the best possible fashion has been a hallmark of Heublein's success for more than a 100 years.

As the pictures and words on the following pages illustrate Heublein foods and beverages are very much a part of today's active American scene.

Sources of Sales and Revenues
(000 OMITTED)



*IMPORTS AND BEAULIEU VINEYARD **PRIMARILY STORE EQUIPMENT AND SUPPLIES AND OTHER RETAIL STORES

Contents

Heublein

Financial Highlights

Year ended June 30	1978	1977	Percent Increase
FOR THE YEAR:			
Revenues	**$1,620,112,000**	**$1,550,902,000**	**4%**
Income before federal, state and foreign income taxes	109,765,000	96,296,000	14
Income taxes	53,236,000	47,528,000	12
Income from continuing operations	56,529,000	48,768,000	16
Net income	**56,529,000**	**41,568,000**	**36**
Earnings per share:			
Continuing operations	2.66	2.28	17
Discontinued operations	—	(.34)	
Net earnings	2.66	1.94	37
Dividends declared per common share	1.38	1.29	7
AT JUNE 30:			
Working capital	238,387,000	235,339,000	
Shareholders' equity	416,069,000	388,557,000	
Shareholders' equity — per common share	19.54	18.26	
Number of common shareholders	28,247	29,071	

Letter to Shareholders

With resumption of strong earnings growth as our prime objective, we directed our will, our energies and our resources to the task and your company concluded the fiscal year in a much improved position.

Income from continuing operations was up 16 percent to $56.5 million; earnings-per-share rose 17 percent to $2.66 and revenues increased four percent to $1.62 billion.

Some hard-won accomplishments during this year reaffirmed our capabilities as a leading marketing company. We tested our operational strengths as never before and found them sound and responsive. This trend toward improvement continued strong with each succeeding quarter.

It was not a year for new ventures so much as it was one for concentrating on operating the existing business and rediscovering strengths and disciplines. Essentially, it was a time to return to basics and to build on them.

Kentucky Fried Chicken, focusing on specific growth programs, concentrated on achieving higher standards of performance. Our International Group called its improvement effort the "Pursuit of Excellence" and made strong strides in major world markets. In the other Operating Groups — Spirits, Wine, Grocery Products and our distillery in Brazil — the aims were the same; the programs had different names, but the overall performance was good.

A year ago three problem areas adversely affected our business. Each was intensively studied, and corrective action plans were launched before the start of the year.

First, Kentucky Fried Chicken executed a nine-point program to increase customer satisfaction with product quality, service and cleanliness at KFC's 4,200 company-owned and franchised stores. The results have been encouraging, and speak well for the future.

Second, our California wine business was restructured so that the principal effort and resources of United Vintners are geared directly to the fastest-growing segments of the California wine industry. It proved successful; United Vintners increased its market share and had the second most profitable year in its history.

Third, in Brazil, where we operate the largest distillery in South America, a new management team was formed and installed under the guidance of Christopher Carriuolo, Heublein's executive vice-president and one of the most experienced executives in the spirits industry. Before the year was out that business was on a sounder footing with an improved balance sheet. Our goal in Brazil is to strengthen our capabilities so as to participate fully in the growth of that vast country's relatively undeveloped spirits and wine markets.

More is said in the following pages of this report about the progress of these several programs.

In our major market, the United States, business was subject to the stop-and-go economy and broad public skepticism about the government's ability to deal with it. Inflation, increased taxes and other higher costs of living cut into consumer discretionary buying power but benefitted brand-name package goods companies, such as Heublein. The working family, with less time to shop, sought the quality and satisfaction associated with well-known brands. This was evident in the increased sales of our best-known spirits, wine and grocery products.

For nearly two decades, we have been closely tracking changing values among the best educated and most affluent populace America has ever seen. We have attuned our marketing strategies accordingly and this year was good evidence of the result.

Our Spirits Group, the largest and most profitable of Heublein's six operating groups, had a record year with case sales growing at a much greater rate than that of the U.S. spirits industry. Most of its leading brands had double-digit gains. Smirnoff vodka pushed ahead to solidify its position as the world's leading spirits brand.

The Grocery Products Group did as well with its popular A.1. Steak Sauce brand and with Ortega Mexican foods. Overseas the consumer trend to well-known brands favored the International Group with strong gains in Smirnoff and KFC sales.

Consumer buying habits have an ever-increasing impact on the world economy and we are basing our plans on careful monitoring of consumer behavior. Along with an anticipatory sense and creativity in marketing, we're emphasizing good execution as the essential follow-through to good planning.

This is especially true at Kentucky Fried Chicken where we meet consumers face-to-face, everyday, in our 777 company-owned and 3,456 franchised U.S. stores. Better store operations are being stressed through in-store training for sales employees and in a course for store managers given at our new training center in Louisville. Incentives for improved performance are also incorporated in the way we compensate store managers; their rewards increase with their success in fulfilling a multi-point improvement program.

One of the largest capital expenditures made at KFC last year was to start updating the image of company-owned stores. The results were convincing enough to encourage many franchisees to follow our lead and for us to accelerate the program in the coming year.

Because KFC serves a chicken meal of good value to an American public that consists largely of young adults, it is in a favorable position to increase its share of the $17-billion U.S. fast-food market.

As the year closed, our Spirits Group was ready to start-up its modern new plant in Paducah, Kentucky, which will ultimately add 40 per cent to our total spirits capacity. It's the fourth in a string of Heublein spirits plants that spans the U.S. from Hartford, Connecticut, to Allen Park, Michigan, and Menlo Park, California. Located close by the Ohio River as it flows into the Mississippi, the new plant will serve markets chiefly in the fast-growing and affluent Sun Belt of the U.S.

It's another milestone in the growth of your company. Only a few years ago Heublein was the fifth largest company in the U.S. spirits industry. Today it's second and growing faster than any other spirits company with such a broad product line. Our spirits brands are the leaders in four of the seven fastest-

growing categories of the industry.

New products have also played a strong part in the success of our spirits business, accounting for a third of case-volume growth in recent years.

Successful new products and plant efficiencies boosted Grocery Products to record level sales and earnings. The new food processing plant at Oxnard, California, completed last year, has virtually doubled our production capacity of sauces, mustard and condiments, and the taco plant at Stoughton, Wisconsin, modernized and expanded this year, increased production to levels that enabled us to broaden distribution and become the nation's leading supplier of tacos.

Overseas, where we have approximately 900 company and franchised KFC stores, our International Group took the same tack as we did in the U.S. It stressed programs aimed at enhancing customer satisfaction with quality, service, and cleanliness and highlighting the value of a KFC meal. While fast foods is still a new concept in many world markets, KFC is growing rapidly, especially in Japan, Australia, and the United Kingdom.

Smirnoff Vodka plays a similar trend-setting role in many overseas markets. It has reached the million-case mark in Canada and the United Kingdom and this year showed a significant increase in other European markets.

We're projecting our international business revenues to grow at twice the rate of those in the U.S. over the next few years.

We strengthened our top management team to help us meet the demands of our expanding, worldwide business. Gwain H. Gillespie, formerly the top financial officer with Chrysler Corporation and an experienced international businessman, joined Heublein in the new post of senior vice-president of finance. Robert A. Martin, a senior executive with broad experience in the alcoholic beverage industry, joined United Vintners as president and chief operating officer.

While the demands of our business had top priority, we committed time, money and effort to discharging social responsibilities that we've undertaken, especially in communities where we operate. We supported the work of health, education and welfare services and gave strong industry leadership to the continuing effort to understand and combat the disease of alcoholism. We also continued to put a moderation message in our alcoholic beverage advertising, a practice we pioneered in our industry starting in January, 1975.

Of our many employee programs, one of the newest and best-received is an Employee Assistance Program designed to help those who are faced with difficult personal problems. For years we have also supported a broad program of aid to education including scholarships for deserving and capable children of our employees. This year 161 young men and women received awards to colleges and universities of their choice under this program. Through attentive administration of our affirmative action program more women and minority group employees advanced to management-level positions this year.

Frances Heublein O'Dell, who served your company as a director for 23 years, resigned at mid-year in accordance with her wish to lessen her business activities. We are deeply grateful for the insights and knowledge she provided us during her long and valuable service. She will continue her association with the company as an honorary director.

Shortly after the close of the year, we reached an agreement with Allied Grape Growers, holder of a minority interest in our United Vintners subsidiary, ending the law suits and legal actions that have been disruptive to our California wine business. As part of the agreement, Heublein is purchasing Allied's 18 percent interest in United Vintners. Further details appear in the footnotes of this report.

In retrospect it was a demanding but encouraging year. In making the gains we did, we proved your company's strengths and resilience and reinforced our own capabilities.

We appreciate the steadfast support given to us by our shareholders, our directors and our employees and, with their continued help, we believe that we can make greater gains for Heublein in the coming year.

Stuart D. Watson

Stuart D. Watson
Chairman

Hicks B. Waldron

Hicks B. Waldron
President

Beverage Operations

Two major trends accounted for practically all the growth of the U.S. alcoholic beverage business this year and favored Heublein above its competitors.

Lightness and flavor, in spirits and wine, continue to be the marked preferences of consumers. Heublein, which helped to originate these trends and is strong in both, accounted for a substantial part of the growth of the country's spirits industry and out-paced the growth of the wine industry.

Beverage sales totaled $923.8 million, a new record, up 10 percent from last year. Operating income increased to $80.4 million, a 10 percent gain.

For the Spirits Group, it was a record year in sales and in total cases shipped; the latter was up almost 10 percent. Aiding the spirits industry's growth is the fact that spirits prices have increased far less than the overall Consumer Price Index in recent years, making spirits a good bargain.

Smirnoff Vodka continued its strong, steady growth with U.S. shipments for the year up three percent, to a record total of 6.5 million cases. Retail sales increased at an even faster rate.

Smirnoff advertising, recognized for its innovation, emphasized the ubiquitousness of the clear light spirit in a series of striking scenes created by some of the world's most famous photographers, among them Irving Penn, Gordon Parks, and Helmut Newton.

Popov Vodka had an exceptional year, with a 29 percent increase in case shipments, making Popov the second Heublein spirits brand to exceed case sales of two million a year.

Other light and flavorful Heublein brands out-paced their respective categories:

— Black Velvet Canadian Whisky had a 17 percent sales increase. Product quality, attractive packaging and memorable advertising helped produce the record sales.

— Lancers Wine, proving its growth potential, had another strong increase in its share-of-market. A new advertising approach — with emphasis on topical radio commercials — and regional and local promotional campaigns were major factors in its success.

— Harveys Bristol Cream, Heublein's most prestigious import, had a substantial sales increase.

— Arrow Cordials, with a 15 percent increase in case shipments, strengthened its position as the country's most popular line of cor-

For people on the move, relaxing moments are made even more enjoyable by the light, flavorful spirits and wines of Heublein.


Smirnoff
80 PROOF
SMIRNOFF
VODKA


230
THUNDERMUG

dials. A new proprietary drink, Caramella, was added to the list of new flavors that have drawn strong consumer interest.

— Heublein prepared cocktails, a major factor in the company's business since the earliest days, made record gains in 1978. Both cocktail lines — Heublein Cocktails and The Club Cocktails in cans and bottles — increased their shipment volume by 30 percent, sparked by the introduction of such new flavors as The Heublein Pina Colada and The Club Cape Codder and Strawberry Daiquiri.

— In the fast growing tequila category, Jose Cuervo, the leader, increased its market share with a sales gain of more than 15 percent. Sales of golden Cuervo Especial and the premium Cuervo 1800 were particularly strong.

— Don Q Rum, Heublein's entry in this expanding category, increased sales almost 18 percent, exceeding the quarter-million case mark for the first time.

Other Heublein brands, or well-known imports sold by Heublein, that scored notable gains were imported Irish Mist Liqueur; Beaulieu Vineyard wines, one of Heublein's renowned Napa Valley wine brands, and Black & White Scotch, which benefitted from the trend toward using top quality scotches at bars and restaurants.

New product introductions helped stimulate both consumer and trade interest during the year. In all, there were ten new products introduced by the Spirits Group.

Yukon Jack, a Canadian liqueur, which is a relatively new product, gained broader distribution this year, and sales exceeded 100,000 cases.

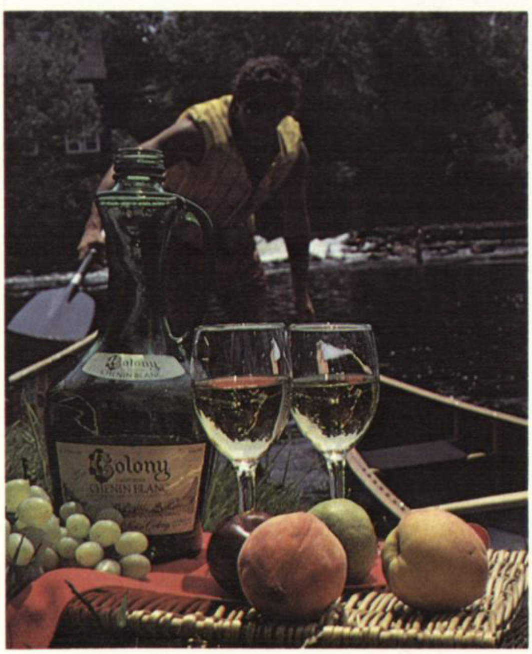
The only major Spirits Group brands with sales declines for the year were Relska Vodka, which felt the impact of intensive price competition early in the year but had stabilized by year's end, and Malcolm Hereford's Cows, which continued to be a high profit contributor despite lower sales. Two new flavors — Amaretto and Cinnamon & Spice — were added to the Cows line and other flavors are under development.

While the Spirits Group has outperformed the industry in recent years by focusing on categories where the growth is the strongest, such as vodka, tequila, cordials, prepared drinks and specialties, its opportunities are not limited to category growth. There are a number of geographic opportunities; major markets where some Heublein brands are not yet fully represented.

For example, Jose Cuervo Tequila is relatively new to the East and Arrow Cordials is a newcomer in the South. As another example, Smirnoff has just begun to realize its potential in the country's largest spirits market, New York City.

Another encouraging sign of the growth potential for Heublein spirits products was noted in what are called the Control States. There are 19 such states in which marketing and sales activities are controlled by state regulation, with spirits sales restricted primarily to state-operated stores.

Despite these marketing limitations, sales of leading Heublein products, including Smirnoff, have been growing at a considerably faster rate in the Control States than in the Open



States. This is especially revealing because Control States' statistics represent the most accurate picture available of true consumer demand.

To help serve this present and potential demand for its products, the Spirits Group will dedicate a newly-constructed, $26-million plant in Paducah, Kentucky this September, adding 40 percent to its total production capacity. This and the other spirits plants strategically located in Hartford, Connecticut; Allen Park, Michigan; and Menlo Park, California provide ready access to the national market.

The underlying strength in the Spirits Group's performance this year, as in the past, was the resourcefulness and energy of its people. One good indication of this is the fact that its sales-per-employee are nearly twice as high as its nearest competitor. With its people, products, promotion and marketing all at high levels, the Spirits Group is in an excellent position to continue to out-perform the industry.

In the Wines Group, Heublein's San Francisco-based United Vintners increased its market share and completed the second most profitable year in its history. Total cases shipped increased 5.7 percent from the prior year. The gains made by its Inglenook and Colony brands were major factors in its success.

So was the realignment of its organization, which enabled it to compete more effectively in the U.S. wine market.

In its new structure, John A. Powers, who has been with United Vintners since 1973, continues as chairman and chief executive officer. Robert A. Martin, with nearly 25 years' experience in the alcoholic beverage business, joined United Vintners early this year as president and chief operating officer.

Three distinct operating companies were established at United Vintners, with company brands divided accordingly — Premium Wines, Standard Wines, and Direct Sales Operations. Each is headed by a Vice President/

General Manager and each has its own sales force.

The new structure accounted for a good part of the year's gains, particularly those made by the Inglenook and Colony brands. While the total market for domestic table wines grew a healthy 8.5 percent, Inglenook and Colony did even better. Inglenook is the fastest-growing major brand in the industry, with an increase of almost 50 percent this year, bringing the brand's total sales to approximately four million cases a year.

Inglenook's Navalle line of table wines has been successful in getting the Inglenook brand featured in many of the nation's finest restaurants and wine shops.

United Vintners' standard wines, under the Colony label, got a new look during the year from attractive new packaging that helped the brand exceed the category growth rate. The brand was particularly strong in varietal and generic table wines, as well as the popular Chablis Quartet — Pink, Gold, Ruby and Emerald.

With these two brands, Inglenook and Colony, United Vintners is the only California wine company with strong representation in both premium and popular-priced table wines, the fastest-growing markets in the industry.

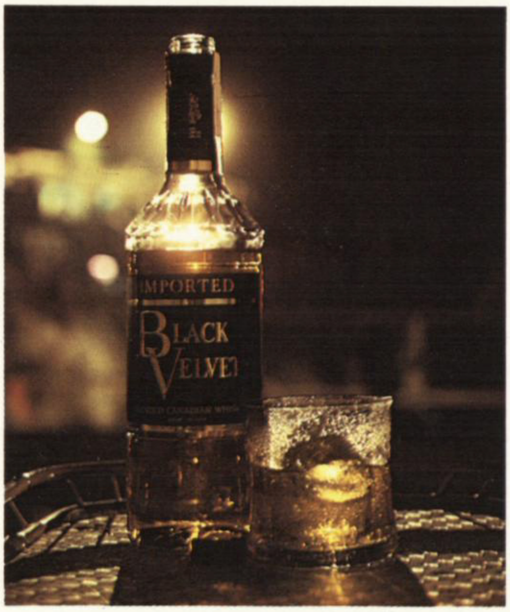
A further industry-wide decline in refreshment and dessert wine sales was recorded in 1978, as expected. With the growth of table wine sales, refreshment and dessert wines became less important to United Vintners.


SMIRNOFF
SILVER
VODKA


IMPORTED
JOSE CUERVO
Black & White
Irish Mist
Tullamore dew
SERRALLES
DON Q
GOLD
PUERTO RICAN RUM


HEREFORD'S
AMARETTO
COWS


Arrow
Arrow
Peppermint Schnapps



United Vintners' Direct Sales Operation, which serves the huge Southern California and Metropolitan New York wine markets, succeeded in getting broader distribution and higher sales in these highly competitive markets.

Electing to concentrate on the growth of existing brands and to expand the market for new products introduced last year, such as Jacaré and HMS Frost, United Vintners refrained from making further new product entries. But, research and development was completed on several products scheduled for introduction in fiscal 1979.

To keep pace with the rising demand, United Vintners made major expenditures to upgrade its wineries at Madera, Oakville, Reedly and Escalon. The emphasis put on improved processing techniques over the past several years has enabled United Vintners to gear production toward the expanding table wine business, to increase its yield per-ton-of-grapes each year for the past five, and to improve the over-all quality of its wines. These technological improvements also are helping United Vintners to combat sharp increases in grape prices, a trend that is expected to continue in fiscal 1979.

From rodeo arenas to summer resorts, Heublein products belong in the American scene.


Kentucky

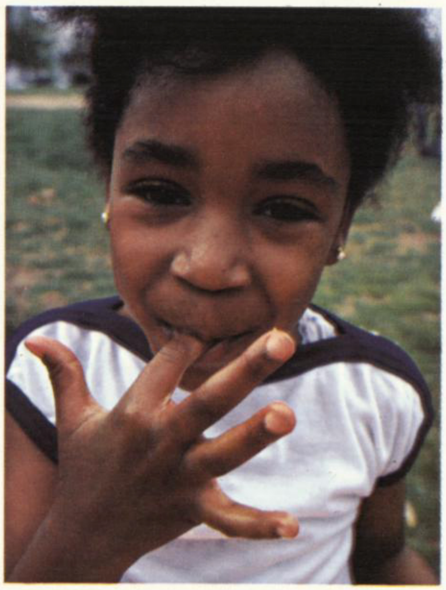
Food Operations

In Heublein's food operations, the Grocery Products Group turned in another record performance, but revenues of the Food Service and Franchising Group declined for most of the year. As expected, the comprehensive action programs undertaken to correct Kentucky Fried Chicken's operating problems did not begin to take effect in time to benefit the Food Service and Franchising Group's results for the year.

Total revenues from food operations were $423.7 million, down 13 percent, while operating income increased seven percent to $32.9 million.

Part of the sales decline at Kentucky Fried Chicken was due to the phase-out of the equipment and supplies operation, which had contributed almost $100 million annually in sales, but was only marginally profitable. The refranchising of more than 100 company-owned stores also reduced sales, but is contributing additional royalty income.

The phase-out of the equipment and supplies operation and the earlier



Kentucky Fried Chicken stores are getting a handsome new look, one which invites customers to come in to enjoy the finger-lickin' goodness of America's favorite chicken meal.

sale of the broiler-producing operations in Alabama were part of a comprehensive plan designed to focus maximum effort on improving KFC's retail store operations.

Improvement in all aspects of operations is the goal of KFC's nine action programs and is the key to increasing its sales and profitability. The action programs are:

1. Improved quality, service and cleanliness in all KFC stores. To support this, all KFC store employees are participating in a rigorous in-store training program.

2. An on-going product improvement program, designed to provide customers with the very best quality chicken, side dishes and desserts.

3. Introduction of a new image for KFC stores. This began in the Columbus, Ohio, market and by year's end had been completed at about 200 company and franchised stores. All new stores, and all relocated or remodeled stores, will conform to this new image. Most will feature in-store seating and convenient drive-thru windows, wherever possible.

4. Construction of additional Kentucky Fried Chicken stores to strengthen the distribution system.

5. Implementation of a new pricing policy at all company-owned stores to assure customers of excellent value.

6. A more effective marketing program, built around a new television advertising campaign which emphasizes the quality of the Kentucky Fried Chicken meal. For the first time in KFC's history, most franchisees are tying their local advertising to the national campaign, thereby increasing its impact.

7. Better motivation of the company's store operating personnel, based on a new compensation system that links employees' compensation more directly to store performance.

8. Installation of a new computerized cash register system at all company stores, to help managers do a better job of controlling food, paper and labor costs.

9. A continuing cost-reduction program, aimed at minimizing nonproductive costs in all areas of the Group's operations.

There's no lack of opportunity in the fast food market, in which Kentucky Fried Chicken competes, as

A delicious meal of Kentucky Fried Chicken caps the pleasure of a brisk bike trip on a sparkling summer day.

annual fast food sales climbed again last year to approximately $17 billion, or about one-third of the total eating-out market.

With 4,233 stores in the U.S. — 777 company-owned and 3,456 franchised — Kentucky Fried Chicken is by far the largest fast-food chicken chain in the U.S. It has more than four times as many stores as its largest direct competitor. A recent survey showed that there is almost universal consumer awareness of KFC's famous trademarks and that nearly 60 percent of all consumers rate Kentucky Fried Chicken as their favorite chicken brand.

Additionally, KFC is the only quick-

Mexican foods are growing faster in popularity in the U.S. than any other ethnic food. Heublein is at the forefront of this trend with its popular line of Ortega-brand tacos, chiles and sauces and its chain of Zantigo Mexican-American quick-service restaurants.

service chain with food made to an exclusive proprietary recipe — the Colonel's Original Recipe. It also is the only company that can offer customers two of their favorite kinds of chicken — Original Recipe and Extra Crispy.

On these unique strengths, Kentucky Fried Chicken is revitalizing and improving its operations, and the action programs undertaken have already begun to produce better store operations and results.

Chicken is served fresher and hotter; salads are tastier; service is measurably faster and more friendly, and cleanliness is the order of the day. As a result, consumer complaints have decreased dramatically and store traffic is increasing.

To keep these programs moving forward and to help KFC regain its high level of profitability, Heublein is backing the effort with a substantial commitment of management and financial resources. In fiscal 1978, more than $19 million was invested in Food Service and Franchising Group capital programs, a clear indication of Heublein's confidence in KFC's future.

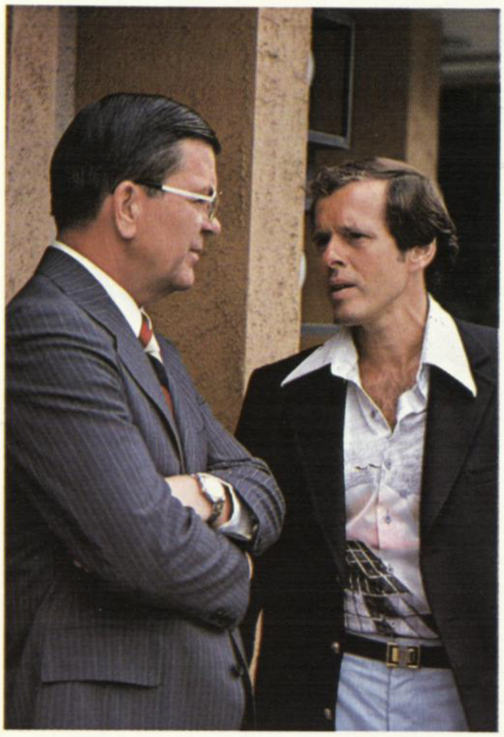
The Food Service and Franchising Group's chain of Zantigo Mexican-American Restaurants was expanded from 35 to 81 units this year. Additional growth is planned even as the concept is being analyzed further to determine its ultimate role in Heublein's fast food operations.

Results at company-owned H. Salt Seafood Galley restaurants were disappointing and some stores were closed. Franchised stores had good results, but no substantial expansion of the Seafood Galley concept is planned.

The Grocery Products Group, which markets premium-brand packaged goods to supermarkets, grocery stores and food-service institutions turned in another record-breaking performance this year, with sales up 16 percent to $118.4 million. This was achieved in a year when the dry grocery business nationwide was up only eight percent and while the Group

Record sales were achieved this year by several of the Grocery Products Group's leading brands, including A.1. Steak Sauce, Grey Poupon Dijon Mustard and Regina Wine Vinegar.

Upper right, Heublein President Hicks B. Waldron discusses progress of Kentucky Fried Chicken's action program with franchisee Doug Beach at Mr. Beach's new image store in Middletown, CT.



was curtailing certain low-profit areas of its business.

The Ortega line of Mexican foods contributed the most to sales growth, while substantial gains came from other leading products, such as A.1. Steak Sauce and Grey Poupon Dijon Mustard.

Supermarket sales of Ortega products grew to the point where the brand now contends strongly for U.S. leadership in the Mexican food category, despite the brand's limited geographical distribution.

Ortega's growth last year came mostly from established categories such as Ortega Chiles and Sauces sold in the Western states and Ortega Taco products sold nationally; from new products, and from expanded distribution of much of the Ortega line into Midwestern markets.

Grocery Products Group sales to restaurants and other foodservice institutions also increased sharply for the year, as these customers were attracted to the menu variety afforded by Mexican foods and as organizational changes a year ago yielded excellent results.

Capital investments made in recent years contributed to this year's strong performance. For example, the new plant in Oxnard, California processed a record crop of chile products with greater efficiency. The new high-speed production line at the taco plant in Stoughton, Wisconsin, enabled Ortega to meet the growing demand for taco shells.

Special marketing programs also spurred the Group's growth. New Mexico's famed motor-car racing brothers, Al and Bobby Unser, who have a long association with Mexican foods, traveled as Ortega's leading spokesmen during the brand's market expansion. Spanish-language radio and television commercials helped Ortega Refried Beans, a new product, become the second leading brand in the major Western market.

Innovations in marketing also helped A.1. Sauce, Grey Poupon Mustard and Regina Wine Vinegar achieve record levels, despite intensified competition.

As beef prices rose, A.1. launched an advertising campaign with the timely theme, "A.1. Makes Every Bite Count." Simultaneously, it employed broad-scale consumer couponing and productive trade promotions to keep A.1. growing against the competition.

The sales level of three of the Group's products declined this year. Snap-E-Tom spicy tomato cocktail lost volume because of its phased withdrawal from the low-margin airline business. The group completed a three-year phased withdrawal from the pimiento business, and Hart's Bakery sales declined due to reduced sales of rolls. This was partly offset by higher sales of other bakery products.

Additionally, the Group's Regal Foods subsidiary was sold at a modest gain late in the fiscal year because the business was not compatible with the Group's long-range strategy.

A new endeavor that proved successful was the separate Foodservice Sales and Marketing units, established to boost sales to the restaurant and institutional food trade. Sales exceeded expectations. Advertising and a specially-tailored distribution network were major factors in these results.

By focusing separately on the foodservice and retail supermarket segments of its business, the Grocery Products Group did a better sales job in both areas, increasing its supermarket sales substantially.

The operational efficiency of a new computerized order entry and order processing system was another major improvement.It speeded up the handling of customer orders, increased cash flow, yielded better sales statistics and provided more control over promotional spending. The system will be expanded in 1979 to include computerized inventory control and after that will be linked with improved accounting, financial and management information systems.

International Operations

Heublein's international operations rebounded strongly this year, achieving record sales and revenues of $272.5 million, a gain of 21 percent. Operating income increased 28 percent to $19.9 million.

Improved performance at the company's big spirits and wine operation in Brazil and strong sales of Smirnoff Vodka and Kentucky Fried Chicken in most major world markets were the key factors.

Also contributing to the year's gains was a restructuring of the international management organization, which afforded added capability for capitalizing on growth opportunities.

Under the new organization, Heublein Industria e Comercio, Ltda. — Heublein's beverage company in Brazil — became a separate operating group, headed by Executive Vice President Christopher W. Carriuolo, Heublein's most experienced spirits and wine executive. José Bassim, with long experience in South American business, was named president of Heublein Industria e Comercio.

Food and beverage operations in all other world markets are managed by the International Group, under the direction of Vice President and Group Executive Barry M. Rowles.

Results in Brazil, Heublein's largest single international market, improved considerably this year as the economy stabilized and the new management team successfully attacked internal operating problems.

With the interest rate in Brazil running as high as 60 percent, one of management's key goals was to reduce short-term bank debt. Substantial progress was made as debt was cut by approximately 50 percent as a result of reducing accounts receivable and inventories to more manageable levels. This produced a saving of $7.2 million in interest costs. Efforts are underway to further improve the balance sheet.

In another action program, steps were taken to improve the distribution system. Key distributors and supermarket operators visited the

Advertising and promotion play a very important role in the growing overseas sales of Smirnoff. In Argentina at the recent World Cup Soccer tournament, Smirnoff's promotion was seen by more than two billion T.V. viewers around the world.In Madrid, outdoor boards feature the versatility of Smirnoff drinks: and most major airline flights carry the popular Smirnoff miniature.


Smirnoff
se prête à tout!


Kentucky Fried Chicken
Kentucky Fried Chicken
ESTACIONAMIENTO

United States this year to study U.S. distribution and marketing methods. They are now applying some of these more sophisticated U.S. techniques to the market in Brazil.

With many distributors working off excess inventory from prior years, sales volume increased only moderately. As in the United States, Heublein is the market leader in several of Brazil's fastest-growing spirit categories, including whisky, cognac and vodka. The company also has a strong entry, called Drink Dreher, in the important vermouth aperitif segment.

Aggressive marketing plans have been developed to strengthen Heublein's leadership in all these categories and to boost sales of several high quality wines, which have good growth potential.

While the vodka market in Brazil is relatively small and undeveloped, it is growing rapidly as consumers come to appreciate vodka's lightness and versatility. Both Smirnoff and Popov increased their market share, and Heublein increased its category coverage by becoming the agent for a popular super-premium imported vodka.

Dreher, S.A., the wine and brandy arm of Heublein Industria e Comercio, continued its outstanding performance of the past several years by once again achieving record sales and profits. Dreher is the largest brandy company in Brazil.

The economic outlook in Brazil for the next two years favors the continued growth of Heublein's beverage business there. The inflation rate is expected to be less severe; there should be relative equilibrium in the balance of payments; and real economic growth of more than five percent is forecast.

To take full advantage of the growth opportunities for Heublein spirits and wines in Brazil, Heublein Industria e Comercio is being transformed into a fully integrated, well-balanced company, fortified with effective management control systems and the latest marketing expertise. Good progress was made this year and the job will be pursued vigorously in fiscal 1979.

In the International Group's Kentucky Fried Chicken business, the goal this year was the same as in the United States — to do a better job of operating the stores, with the emphasis on improved product quality and upgraded facilities.

There are now 896 company-owned and franchised stores in the international Kentucky Fried Chicken system, doing business in 44 countries. Sixty-four stores were added to the system this year and another 72 were remodeled.

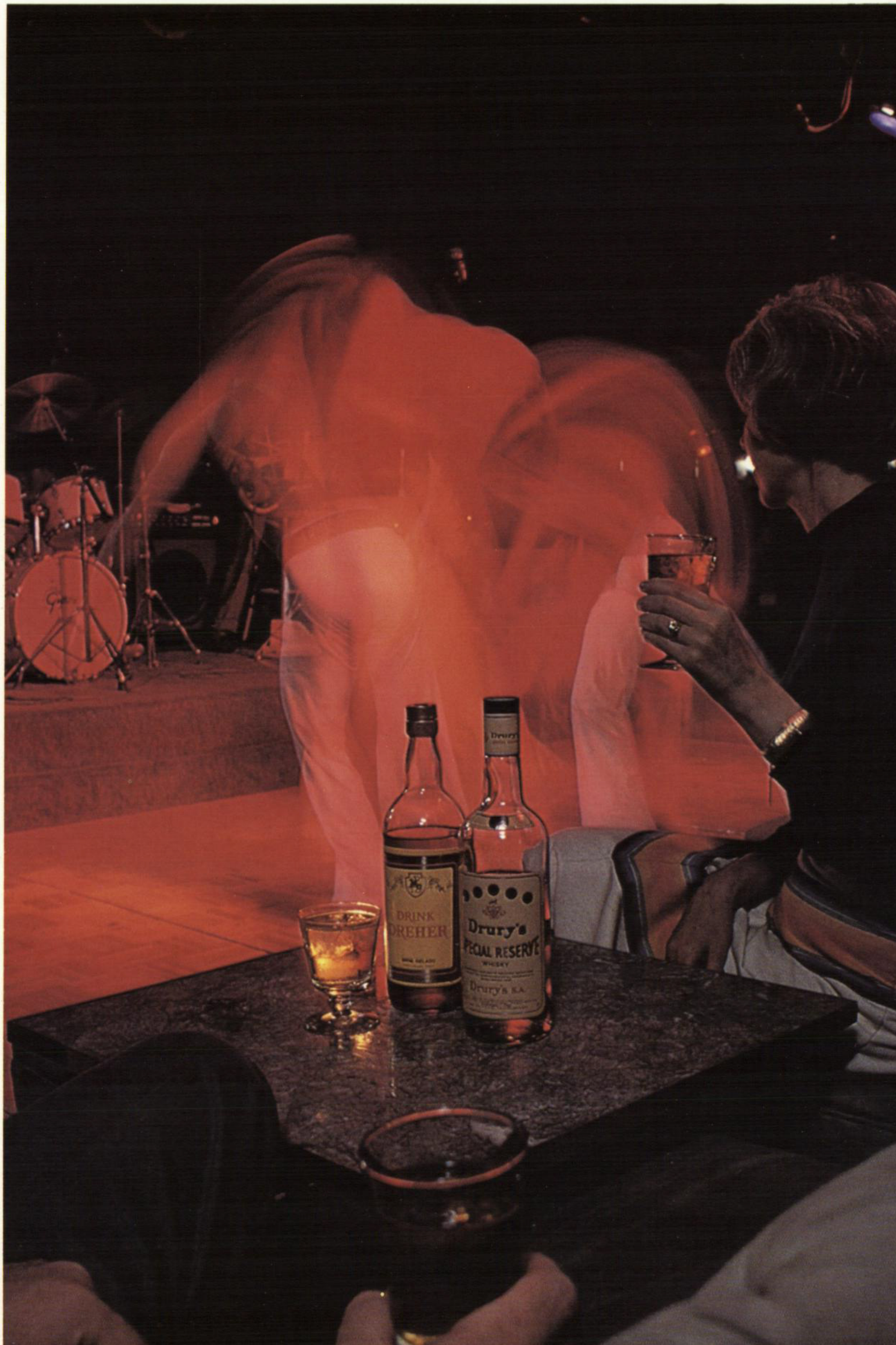
A rigorous "Pursuit of Excellence" campaign was conducted at all company-owned stores. The campaign included more frequent store inspections, the use of "mystery shoppers", and an expanded training program for store personnel. This campaign had good results and is being continued.

A highlight of the year was the performance of KFC-Japan, which increased sales by more than 50 percent, strengthening its position as Japan's leading fast food chain. Approximately half the sales gain came from volume growth and half from the strengthening of the yen vs. the U.S. dollar. Six new company-owned KFC stores and 15 franchised stores were opened there to bring the total to 164.

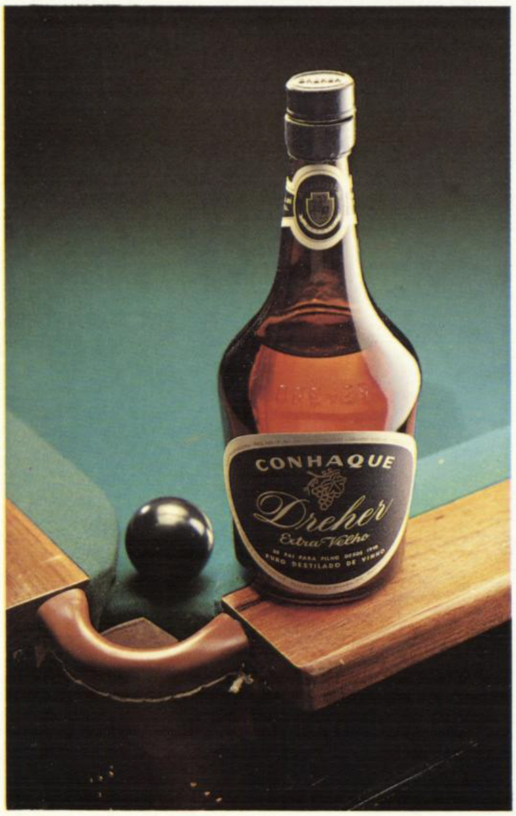
Sales gains in Japan were spurred by an expanded advertising and promotional campaign, and by the modernization of store facilities. In addition, KFC-Japan has been able to hold its prices stable for more than two years by increasing productivity, thereby providing consumers with better value for their money.

Other strong markets for Kentucky Fried Chicken this year included the Caribbean, where franchisees united in an effective cooperative marketing program; and the United Kingdom, where all 45 company stores in London were remodeled. There was strong consumer response in London, with per-store sales averages up more

Whether it is an after-tennis Smirnoff cooler in Old Montreal, chicken dinner in Mexico City's newest KFC store, or a visit from Colonel Sanders in Tokyo, Heublein brands are well-known and widely-used in the world's major markets.



Heublein Industria e Commercio Ltda., the largest distiller in the southern hemisphere, markets Brazil's leading brands of whiskey and brandy.



than 30 percent over the prior year.

In Australia, the largest international market for KFC, per-store sales increased slightly but profits were depressed by the higher cost of doing business in the sluggish Australian economy. To help the business grow, an extensive store remodeling program is now in progress, including the addition of in-store seating and drive-thru service windows at many stores.

Kentucky Fried Chicken has pioneered the fast food concept abroad and is the leading fast food chain internationally. But fast food is still a new concept in most world markets and Kentucky Fried Chicken has just begun to tap its potential abroad. Experience shows that by being sensitive to local styles and tastes, the KFC concept can be adapted successfully to different market situations around the world.

In much the same manner, the International Group has had great success in extending the "vodka revolution", which took place earlier in the United States, to many major world markets.

Smirnoff sales abroad increased again this year at a considerably faster rate than in the United States. Canada joined the United Kingdom as a million-case market for Smirnoff and there also were healthy sales increases in Ireland, Norway and Iran.

A prototype international advertising campaign for Smirnoff, readily adaptable for use in almost any market, was developed this year under the direction of International Group headquarters in Farmington, Conn. The campaign features a surreal 60-second film designed to be shown in movie houses, along with a complementary print advertising campaign for undeveloped vodka markets.

The campaign was tested in West Germany and is scheduled to run soon in Italy, Belgium, Venezuela, Peru, Panama and other markets.

As in the United States, sports promotions often are used abroad to keep Smirnoff in the limelight. The most extensive Smirnoff promotion ever held abroad took place this year, in connection with the World Cup Soccer tournament in Argentina. Smirnoff licensees in two dozen countries participated in the promotion, which helped put the Smirnoff name on view to an estimated two billion television viewers around the world.

While continuing to expand the international market for Smirnoff, the International Group also is exploring ways to broaden its beverage business by developing markets for more of the light, flavorful Heublein drinks that are so popular in the United States.

One international beverage operation that's increasingly successful is J. M. Fonseca Exportador, the International Group's joint venture in Portugal with J. M. Da Fonseca, makers of Lancers and other fine wines. Exportador had a record year, with export sales up more than 30 percent to almost 500,000 cases.

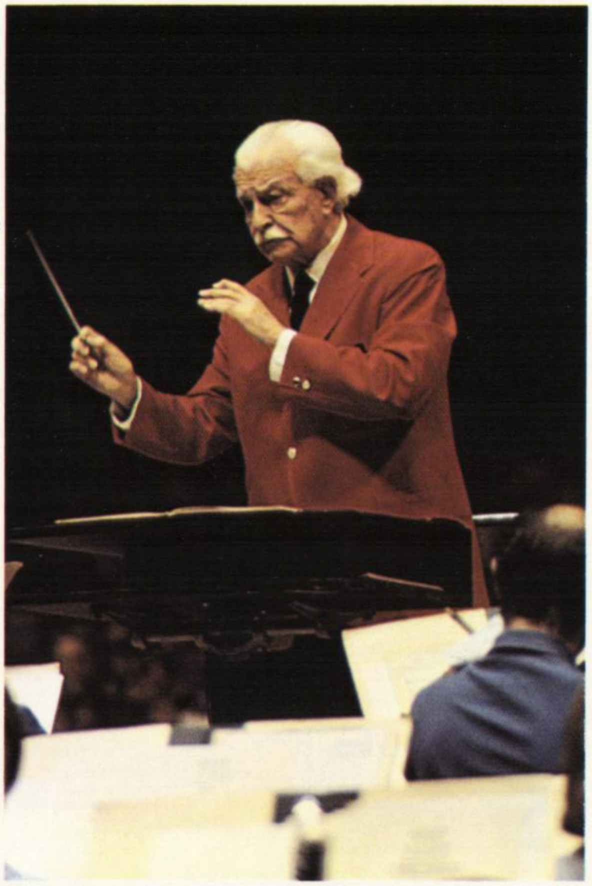
The Exportador venture exemplifies Heublein's policy of establishing close associations with knowledgeable business partners, whose local expertise is invaluable in dealing with the different economic, political and cultural conditions that exist in various countries.

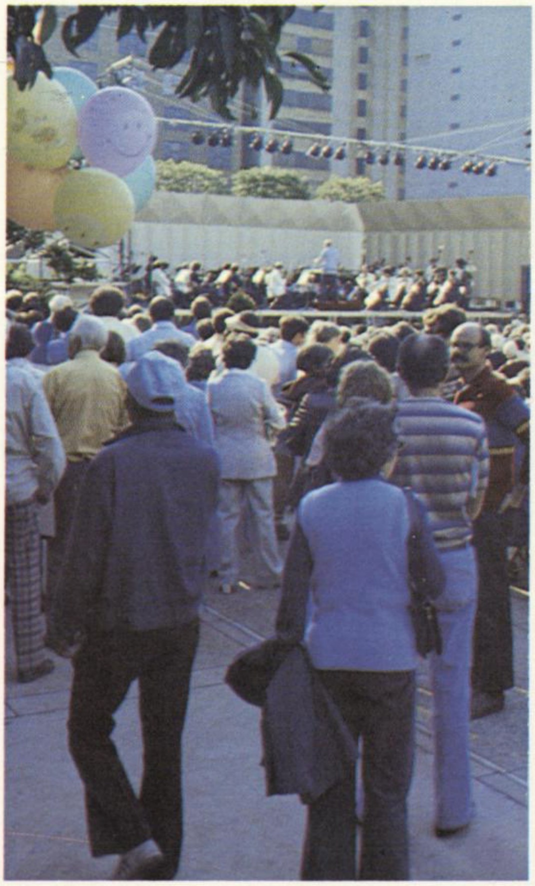
At the same time, every effort is made to channel Heublein's domestic know-how in foods and beverages into world markets. To speed up this process, management at International Group headquarters was restructured this year on product-oriented lines.

Two new senior vice president positions were created, one for foods and one for beverages. These executives and their staffs will work closely with management abroad and with the domestic food and beverage groups to stimulate a more productive exchange of ideas and information.

Another important advance was made in Mexico, where a joint venture was established by the International Group and the Cuervo Group, the firm that produces Jose Cuervo Tequila and other spirits. Under the agreement Cuervo owns 51 percent of the KFC operation in Mexico, which should pave the way for the expansion of KFC in Mexico.

As a responsible corporate citizen, Heublein supports many organizations and activities which enhance the quality of life in communities where it operates. Some of the activities made possible, in part, by Heublein's support are shown here, including a special Christmas concert in Hartford by Arthur Fiedler and the Boston Pops (right); the week-long Greater Hartford Civic and Arts Festival (far right); and an expanded national tour by the highly acclaimed Hartford Ballet Company.





Financial Statements

Summary of Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. The Company's investments in affiliated companies (not majority-owned) are accounted for on the equity basis and the Company's operating results include its share of their net income. All significant intercompany transactions are eliminated in consolidation.

Inventories

Inventories are stated at the lower of cost or market, cost being determined by the first-in, first-out method, except certain bulk whiskey and wine, the cost of which has been determined by specific lots.

Whiskey and wine in storage for aging over a number of years is included in current assets in accordance with general industry practice.

Property, Plant and Equipment

Depreciation and amortization generally are computed by the straight-line method over the estimated useful lives of the respective assets or the terms of the related leases. On sale or retirement, the asset cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in income. Expenditures which extend the useful lives of assets are capitalized while maintenance and repairs are charged to income as incurred.

Cost in Excess of Net Assets of Purchased Businesses, Trademarks, Contracts and Franchises

Cost in excess of net assets of purchased businesses is being amortized over periods ranging from 10 to 40 years except for $4,016,000, relating to an acquisition prior to November 1, 1970 which is not being amortized as, in the opinion of management, there has been no diminution in value.

Trademarks, contracts and franchises are carried at cost less amortization which is being provided principally on a straight-line basis over periods ranging from 5 to 20 years.

Franchise and License Fees

Initial franchise fees are recorded as income on the date the store is opened by the franchisee. Monthly fees from franchisees and licensees are accrued as earned based on their sales.

Taxes

Deferred income taxes result from timing differences between tax and financial recognition of income and expense. The principal items causing timing differences are provisions for losses on disposition of discontinued operations and accelerated depreciation.

The investment tax credit is deducted from federal income tax expense in the year in which the related asset is placed in service.

United States and Canadian excise taxes constitute a lien on in-bond inventories. Since these taxes are not payable until withdrawal from bond or after twenty years, whichever is earlier, excise taxes have not been accrued with respect to such inventories in accordance with industry practice.

Pension Plans

The Company has non-contributory retirement plans which cover substantially all full-time domestic employees except certain employees covered by union pension plans. Under collective bargaining agreements, the Company makes contributions to various pension plans for certain union employees. Pension costs charged to current earnings include charges for current service and amortization of prior years' service costs over 30 years. The Company's policy is to fund amounts accrued.

Earnings Per Share

Primary earnings per share are based on the weighted average number of common and common equivalent shares outstanding during each year.

Fully diluted earnings per share also includes the effects of the remaining dilutive stock options and convertible securities.

Consolidated Statement of Income

Dollars in thousands except per share data	Year ended June 30, 1978	1977
Revenues:		
Net sales	$1,577,114	$1,511,188
Franchise and license fees	42,998	39,714
	1,620,112	**1,550,902**
Costs and expenses:		
Cost of sales	1,132,870	1,093,600
Selling, advertising, administrative and general expenses	354,014	338,042
	1,486,884	1,431,642
Operating income	133,228	119,260
Other income (deductions):		
Interest expense:		
Long-term debt	(13,142)	(13,267)
Other	(9,226)	(16,284)
Interest income	4,690	2,726
Miscellaneous—net	(5,785)	3,861
	(23,463)	(22,964)
Income from continuing operations before income taxes	109,765	96,296
Income taxes:		
Federal	41,659	37,560
State	7,744	5,163
Foreign	3,833	4,805
	53,236	47,528
Income from continuing operations	**56,529**	**48,768**
Discontinued operations:		
Loss from poultry operations, less tax effect	—	(520)
Provision for discontinuance of poultry operations including operating losses during phase-out period, less tax effect	—	(6,680)
	—	(7,200)
Net income	**$ 56,529**	**$ 41,568**
Earnings per share:		
Primary:		
Continuing operations	**$2.66**	**$2.28**
Discontinued operations	—	(.34)
Net earnings	**$2.66**	**$1.94**
Fully diluted:		
Continuing operations	**$2.59**	**$2.23**
Discontinued operations	—	(.31)
Net earnings	**$2.59**	**$1.92**

See accompanying notes and summary of accounting policies.

Consolidated Balance Sheet

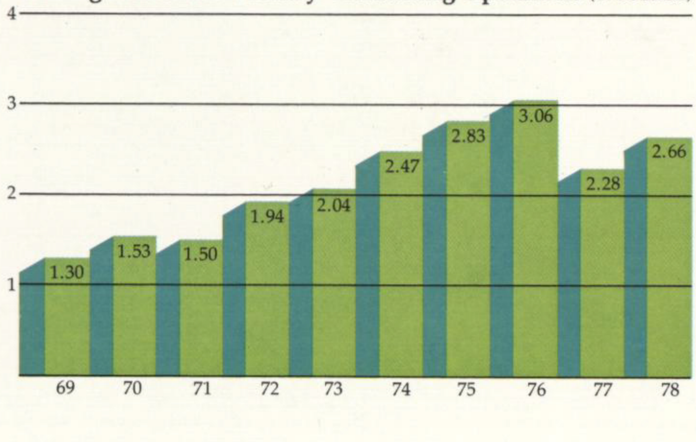
Dollars in thousands	June 30, 1978	June 30, 1977
ASSETS		
Current assets:		
Cash	$ 19,338	$ 23,848
Marketable securities, at cost which approximates market	46,157	9,838
Accounts and notes receivable	170,918	188,162
Inventories:		
Finished products	77,257	78,841
Products in process	2,926	3,775
Bulk whiskey and wine	112,649	109,548
Raw materials	24,865	27,203
Total inventories	217,697	219,367
Prepaid expenses	9,266	10,164
Total current assets	**463,376**	**451,379**
Investment in and advances to affiliated companies	**18,560**	**15,857**
Property, plant and equipment, at cost:		
Land and land improvements	44,494	43,043
Buildings	99,021	97,032
Machinery and equipment	188,803	168,045
Leasehold improvements	52,414	44,242
Construction work in progress	38,276	25,755
	423,008	378,117
Less accumulated depreciation and amortization	129,018	113,129
Net property, plant and equipment	**293,990**	**264,988**
Other assets:		
Cost in excess of net assets of purchased businesses	50,812	50,645
Trademarks, contracts and franchises	2,796	3,006
Deferred income taxes	4,707	122
Other	27,147	33,122
	85,462	**86,895**
	$861,388	**$819,119**

Income-Continuing Operations (IN MILLIONS OF DOLLARS)

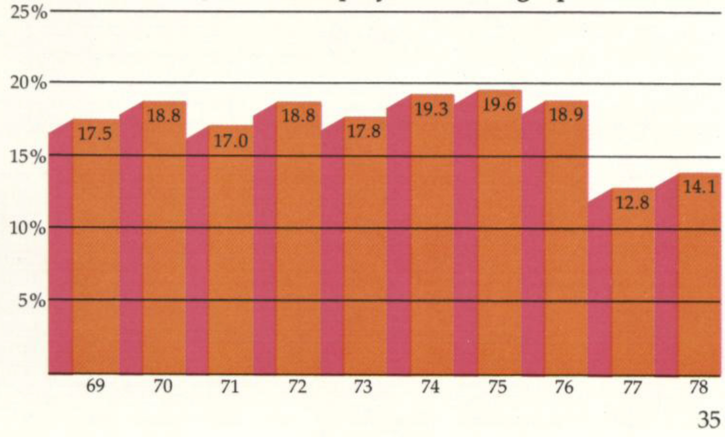
	June 30, 1978	June 30, 1977
LIABILITIES		
Current liabilities:		
Notes payable	$ 23,899	$ 31,596
Current portion of long-term debt	2,648	2,839
Accounts payable	64,689	53,698
Accrued expenses	56,767	56,419
Taxes:		
Federal, state and foreign income taxes	24,018	19,905
Excise taxes	32,208	29,691
Other taxes	11,091	11,164
Dividends payable	7,473	7,057
Current portion of reserve for discontinued operations	2,196	3,671
Total current liabilities	**224,989**	**216,040**
Long-term debt due after one year	**198,697**	**198,266**
Reserve for discontinued operations	**7,434**	**8,779**
Other long-term liabilities and deferred income	**9,901**	**3,587**
Minority interest	**4,298**	**3,890**
SHAREHOLDERS' EQUITY		
Preferred stock	1,345	1,513
Common stock	10,614	10,605
Additional paid-in capital	144,204	143,793
Retained earnings	260,236	232,976
	416,399	388,887
Less treasury stock, at cost	330	330
Total shareholders' equity	**416,069**	**388,557**
	$861,388	**$819,119**

See accompanying notes and summary of accounting policies.

Earnings Per Share-Primary-Continuing Operations (IN DOLLARS)



Return on Shareholders' Equity-Continuing Operations



Consolidated Statement of Additional Paid-in Capital

Dollars in thousands

	Year ended June 30, 1978	1977
Balance at beginning of year	**$143,793**	**$141,973**
Excess of option price over stated value of common stock issued on exercise of options	383	1,352
Excess of stated value of preferred stock converted over stated value of common stock	8	24
Tax benefit from exercise of nonqualified options issued under stock option plans	20	444
Balance at end of year	**$144,204**	**$143,793**

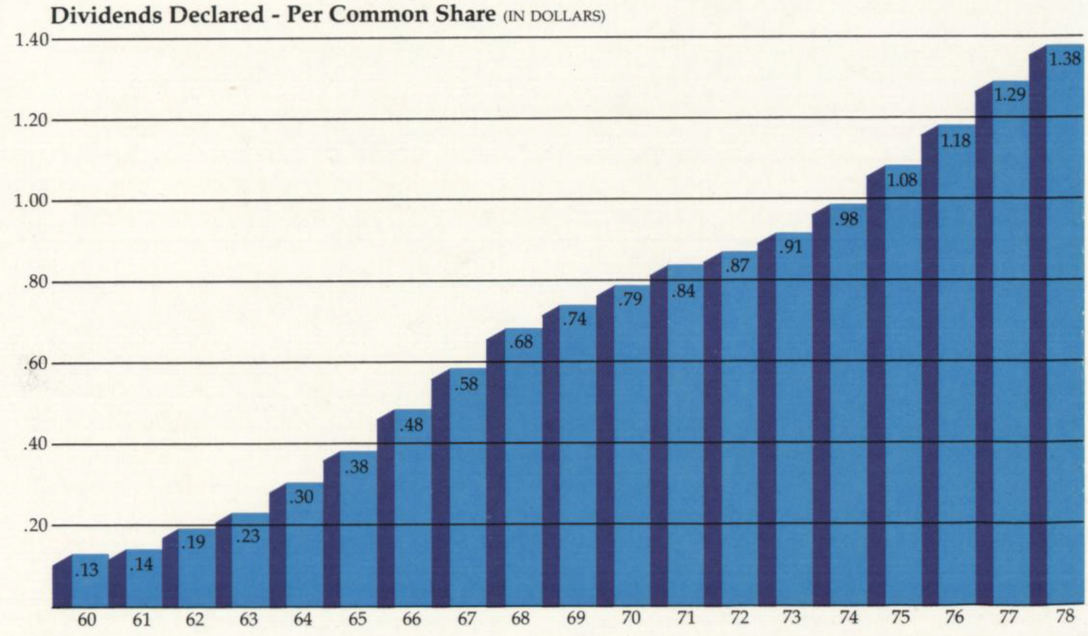
Consolidated Statement of Retained Earnings

Dollars in thousands except per share data

	Year ended June 30, 1978	1977
Balance at beginning of year	**$232,976**	**$218,741**
Net income	56,529	41,568
Dividends declared on common stock—$1.38 per share ($1.29 in 1977)	(29,269)	(27,333)
Balance at end of year	**$260,236**	**$232,976**

See accompanying notes and summary of accounting policies.

Dividends Declared - Per Common Share (IN DOLLARS)



Consolidated Statement of Changes in Financial Position

Dollars in thousands

	Year ended June 30, 1978	1977
SOURCES OF WORKING CAPITAL		
Continuing Operations:		
Income from continuing operations	$ 56,529	$ 48,768
Charges (credits) not requiring funds:		
Depreciation and amortization	27,020	23,714
Deferred income taxes	1,033	993
Equity in earnings of unconsolidated affiliates	(2,334)	(1,785)
Minority interest in earnings of subsidiaries	408	322
Funds provided from continuing operations	82,656	72,012
Discontinued operations:		
Loss from discontinued operations	—	(520)
Provision for phase-out of discontinued operations	—	(6,680)
Charge not requiring funds — depreciation	—	404
Funds provided from operations	82,656	65,216
Book value of assets sold, including properties not used in continuing operations	17,941	28,335
Changes in other long-term liabilities and deferred income	6,314	358
Increase in long-term debt	3,772	2,258
Proceeds from exercise of stock options	391	1,379
	111,074	**97,546**
USES OF WORKING CAPITAL		
Additions to property, plant and equipment	68,931	55,819
Dividends declared	29,269	27,333
Additions to cost in excess of net assets of purchased businesses, trademarks, contracts and franchises	3,424	362
Reduction of long-term debt	3,341	5,433
Increase in other assets	1,437	2,801
Reduction of long-term portion of reserve for discontinued operations	1,345	1,711
Redemptions and conversions of series preferred stock	168	427
Other — net	111	(1,335)
	108,026	**92,551**
Increase in working capital	**$ 3,048**	**$ 4,995**
CHANGES IN WORKING CAPITAL		
Cash and marketable securities	$ 31,809	$ 11,805
Accounts and notes receivable	(17,244)	(33,695)
Inventories	(1,670)	7,614
Prepaid expenses	(898)	2,839
Notes payable and current portion of long-term debt	7,888	(1,053)
Accounts payable, accrued expenses and taxes	(17,896)	19,318
Dividends payable	(416)	(662)
Current portion of reserve for discontinued operations	1,475	(1,171)
Increase in working capital	**$ 3,048**	**$ 4,995**

See accompanying notes and summary of accounting policies.

Notes to Consolidated Financial Statements

Discontinued Operations

Operating losses and disposal costs charged against the reserve for discontinuance of Kentucky Fried Chicken Corporation's owned roast beef and domestic fish and chips outlets and three motor hotels (provided for in prior years) aggregated $1,836,000 in fiscal 1978 and $2,220,000 in fiscal 1977. Management believes the remaining reserve is adequate to complete the discontinuance of these operations. Remaining assets related to these operations, included in other assets, were $5,256,000 in 1978 and $7,050,000 in 1977.

In the first quarter of fiscal 1977, the Company's poultry operations sustained a pretax loss of $1,004,000 on revenues of $27,142,000 and management decided to dispose of such business. A provision of $6,680,000 (net of tax benefit of $2,492,000) was made for operating losses of the poultry operations to the date of disposition and other losses expected to be sustained upon disposition of its assets. These poultry operations were sold in fiscal 1977 for cash and short-term notes which were collected in fiscal 1978. Operating losses subsequent to September 30, 1976, disposal costs and estimated costs of a related litigation settlement charged against the reserve through June 30, 1978 aggregated $8,472,000 (including $980,000 in fiscal 1978) before tax benefit. Management believes the remaining reserve is adequate to complete this disposal.

Taxes

The provision for federal income taxes includes deferred tax charges (credits) resulting from the following:

	1978	1977
	(In thousands)	
Excess of tax over book depreciation	$1,508	$1,750
Losses from discontinued operations provided for in prior periods	706	1,193
Other items	(1,181)	(1,957)
Provision for deferred income taxes	$1,033	$ 986

The consolidated effective tax rate was 48.5% for 1978 and 49.4% for 1977. Items affecting this rate which were in excess of 5% of the 48% statutory federal rate were: 1978 — 3.7% from state and local taxes, net of federal income tax benefit; and 1977 — 4.9% due to foreign losses for which no tax benefit was currently available, (4.4)% from reduction of excess federal income tax reserves and 2.8% from state and local taxes, net of federal income tax benefit.

Provision for foreign income taxes of foreign subsidiaries is made where applicable. No provision for federal income taxes has been made on the undistributed earnings of foreign subsidiaries since it is management's intent to reinvest substantially all earnings of foreign subsidiaries abroad. The undistributed earnings of foreign subsidiaries for which federal income taxes have not been provided at June 30, 1978 aggregate $17,345,000. If such earnings were distributed, income tax credits would be available to reduce any resulting income tax liability.

Net sales include excise taxes of $429,810,000 in 1978 and $399,849,000 in 1977.

Short-Term Borrowings and Long-Term Debt

Average U.S. and foreign short-term borrowings during fiscal 1978 and 1977 were $30,865,000 and $55,038,000 at weighted average interest rates of 26.4% and 30.5%, respectively. Borrowings reached maximum month-end balances of $38,653,000 and $79,824,000 at September 30, 1977 and March 31, 1977, respectively. Short-term borrowings at June 30, 1978 and 1977 were at weighted average interest rates of 21.9% and 38.0%, respectively. These amounts related primarily to borrowings of foreign subsidiaries, principally Brazil, amounting to $23,899,000 and $30,558,000 for 1978 and 1977, respectively.

At June 30, 1978 and 1977, the Company had available unsecured lines of credit from several domestic banks aggregating $21,800,000 for both years, and from foreign banks aggregating $39,000,000 and $30,000,000, respectively. In connection with its domestic credit lines, the Company is expected to maintain average bank balances approximating 10% of the credit lines when not in use and an additional 10% when in use. Such balances are not legally restricted as to utilization or withdrawal and are generally met with normal operating balances.

Long-term debt due after one year follows:

	June 30, 1978	1977
	(In thousands)	
4½% convertible subordinated debentures due May 15, 1997	$100,000	$100,000
8⅜% Notes due February 15, 1985	90,000	90,000
Mortgage notes payable in various installments	3,182	3,497
Other	5,515	4,769
	$198,697	$198,266

The 4½% subordinated debentures are convertible into common stock at approximately $69.50 per share (1,438,800 shares) and are subject to redemption through annual sinking fund payments beginning in 1983 of not less than 6% nor more than 12% of the principal amount of debentures outstanding in 1982.

The 8⅜% Notes may not be redeemed before February 15, 1983. On or after that date, the Notes may be redeemed at the option of the Company in whole or in part at their principal amount, plus accrued interest.

Mortgage notes payable are collateralized by deeds of trust, leasehold improvements, buildings, equipment and other assets with a net carrying amount of approximately $6,487,000 at June 30, 1978.

The most restrictive term of long-term borrowing agreements limits the payment of cash dividends. Consolidated retained earnings not so restricted at June 30, 1978 amounted to approximately $166,246,000.

Aggregate maturities of long-term debt for the next five fiscal years are as follows: 1979 — $2,648,000; 1980 — $2,221,000; 1981 — $2,365,000; 1982 — $319,000; and 1983 — $6,327,000.

Capital Stock

There are 5,000,000 authorized shares of series preferred stock. Changes in outstanding preferred stock during 1978 and 1977 are summarized below:

	Series A Convertible non-dividend stated value $10 per share		Series B Convertible non-dividend stated value $10 per share	
	Shares	Amount	Shares	Amount
Balance at July 1, 1976	250,588	$1,602,000	33,772	$ 338,000
Conversions to common stock	(54)	—	(2,391)	(24,000)
Redemptions (including partial redemptions)	(56,818)	(386,000)	(1,645)	(17,000)
Balance at June 30, 1977	193,716	1,216,000	29,736	297,000
Conversions to common stock	(150)	(1,000)	(636)	(6,000)
Redemptions (including partial redemptions)	(23,849)	(138,000)	(2,303)	(23,000)
Balance at June 30, 1978	169,717	$1,077,000	26,797	$ 268,000

Each Series A preferred share is convertible into .10 share of common stock and is also redeemable in whole or in part at the option of the holder. Partial redemptions do not reduce the number of shares outstanding. Series B preferred stock is convertible into .2974 share of common stock and is also redeemable in sub series. The Company has the option to redeem both classes in whole or in part for $10 per share, less any amounts theretofore paid in partial redemption.

Authorized capital stock also includes 500,000 shares of 5% preferred stock, par value $100 per share and 200,500 shares of 5% convertible preferred stock, par value $100 per share, none of which were outstanding during 1978 and 1977.

There are 30,000,000 authorized shares of common stock with a stated value of $.50 per share. The changes in outstanding shares in 1978 and 1977 are summarized below:

	1978		1977	
	Issued	In Treasury	Issued	In Treasury
Shares at beginning of year	21,209,414	7,650	21,155,048	7,650
Shares issued upon exercise of stock options	16,041		53,512	
Conversions of preferred shares	47		854	
Shares issued in final settlement of contingent payout agreement	3,086		—	
Shares at end of year	21,228,588	7,650	21,209,414	7,650

At June 30, 1978 and 1977, shares of common stock were reserved as follows:

	1978	1977
Conversion of outstanding:		
4½% convertible subordinated debentures	1,438,800	1,438,800
Series A convertible preferred stock	10,484	11,881
Series B convertible preferred stock	7,969	8,843
Stock options	1,429,286	1,447,821
	2,886,539	2,907,345

Stock Options

Options outstanding were granted under the Company's Qualified Stock Option Plan which expired on October 21, 1974, the 1971 Stock Option Plan, and the 1974 Stock Option Plan.

The Qualified Stock Option Plan provided for the granting of options for the purchase of 1,000,000 shares at option prices not less than the fair market value of the Company's common stock on the date of grant. The terms of the options did not exceed five years. The 1971 and 1974 Stock Option Plans provide for the granting of options, both qualified and non-qualified, for the purchase of 500,000 and 1,000,000 shares of common stock, respectively, at option prices not less than the fair market value of the Company's common stock on the date of grant. The terms of the qualified and non-qualified options may not exceed five years and ten years, respectively.

Changes in options outstanding during the years ended June 30, 1978 and 1977 were as follows:

	1978	1977
Outstanding options at beginning of year	1,047,707	1,150,107
Granted (at $23.69 to $27.63 per share)	455,878	—
Exercised	(16,041)	(53,512)
Cancelled	(112,516)	(48,888)
Outstanding options at end of year	1,375,028	1,047,707

Options exercisable at June 30, 1978 and 1977 aggregated 526,613 and 225,684, respectively.

Information regarding options which were exercised, became exercisable or were outstanding follows:

	Number of Shares	Option price		Market price*	
		Per share	Aggregate	Per share	Aggregate
1978:					
Exercised	16,041	$23.81 to 25.38	$ 392,000	$25.00 to 29.56	$ 435,000
Became exercisable	341,245	23.81 to 48.56	10,598,000	24.63 to 27.56	8,966,000
Outstanding at June 30	1,375,028	23.69 to 48.56	40,704,000	26.88	36,954,000
1977:					
Exercised	53,512	23.81 to 42.94	1,379,000	23.94 to 52.38	2,209,000
Became exercisable	276,640	23.81 to 64.69	6,958,000	23.63 to 52.38	11,483,000
Outstanding at June 30	1,047,707	23.81 to 74.07	33,199,000	25.00	26,193,000

*At dates exercised, became exercisable, or June 30, respectively.

At June 30, 1978 and 1977 there were 54,258 and 400,114 shares, respectively, available for future grant. No charges have been made to income in connection with options granted to date.

Pension and Profit-Sharing Plans

Pension expense was $7,989,000 in 1978 and $5,876,000 in 1977. The increase in pension expense is due to changes in actuarial assumptions and the net experience gains and losses of the pension plans.

The Company's contribution under its profit sharing plan for salaried employees is the lesser of 8% of net income, as defined, or 8% of participants' salaries, as defined. Contributions by the Company to the Plan amounted to $4,360,000 in 1978 and $3,780,000 in 1977.

Leases

The Company leases land, buildings, and equipment. Many of these leases contain renewal options and some include escalation clauses. In accordance with Financial Accounting Standard No. 13 (FAS 13), certain leases (immaterial in amount) originating after December 31, 1976 have been capitalized.

Future minimum lease payments under noncancelable leases are summarized below. Included in operating leases are certain leases entered into prior to December 31, 1976, which will be capitalized in 1979 under FAS 13.

	Capital leases	Operating leases
	(In thousands)	
Fiscal year ending June 30,		
1979	$1,350	$ 12,270
1980	1,386	10,773
1981	906	10,001
1982	434	9,130
1983	607	8,278
Thereafter	1,196	53,114
Total minimum lease payments	5,879	$103,566
Less amount representing interest	1,591	
Present value of minimum lease payments	$4,288	

Rental expense, net of minor sublease income, was $21,410,000 in 1978 and $21,997,000 in 1977, including contingent rental expense of $1,626,000 and $1,728,000, respectively. The most significant portion of contingent rental expense relates to the payment of mileage charges on transportation equipment.

When the Company retroactively applies FAS 13 in fiscal 1979 for leases in existence at December 31, 1976, the following assets and liabilities will be included in the consolidated balance sheet:

	June 30,	
	1978	1977
	(In thousands)	
Leased property, net of accumulated amortization:		
Buildings	$18,381	$20,114
Machinery and equipment	1,295	2,960
Total	$19,676	$23,074
Capitalized lease obligations	$24,177	$27,111

The capitalization of these leases would have decreased net income by $239,000 in 1978 and by $151,000 in 1977.

Business Segments

The Company operates principally in four business segments: production and marketing of distilled spirits and prepared cocktails (Spirits), production and/or marketing of wines and brandies (Wines), production and sale of specialty food products (Grocery) and operating and franchising Kentucky Fried Chicken, H. Salt Seafood Galley and Zantigo Mexican-American Quick Service Restaurants (Restaurants).

The business segments and geographical areas for the year ended June 30, 1978 are presented below:

	Business segments					
	Spirits	Wines	Grocery	Restaurants	Corporate	Consolidated
			(In thousands)			
Revenue	$742,575	$324,794	$118,160	$434,583	$ —	$1,620,112
Operating profit	73,081	28,687	17,942	25,662		$ 145,372
Corporate expenses and miscellaneous — net						(13,239)
Interest expense						(22,368)
Income before income taxes						$ 109,765
Identifiable assets	272,011	219,696	61,104	218,507	90,070	$ 861,388
Capital expenditures	18,847	14,460	2,429	32,537	658	$ 68,931
Depreciation & amortization	4,536	5,223	2,684	14,067	510	$ 27,020

	Geographic areas			
	United States	Brazil	Remaining foreign geographic areas	Consolidated
			(In thousands)	
Revenue	$1,347,589	$115,529	$156,994	$1,620,112
Operating profit	122,694	4,689	17,989	$ 145,372
Corporate expenses and miscellaneous — net				(13,239)
Interest expense				(22,368)
Income before income taxes				$ 109,765
Identifiable assets	602,792	83,156	85,370	$ 771,318
Corporate assets				90,070
Total assets				$ 861,388

Intersegment, intergeographical and export transactions are not significant.

Operating profit of each segment is total revenue less operating expenses. In computing operating profit, none of the following has been added or deducted: general corporate expenses, interest expense, income taxes, equity in income of unconsolidated affiliates or minority interest in earnings of subsidiaries.

Corporate identifiable assets are principally cash and marketable securities.

The Company's foreign revenue, operating profit and identifiable assets for 1977 amounted to $225,137,000, $21,986,000, and $165,263,000, respectively. Foreign exchange gains for fiscal 1978 and 1977 were $2,748,000 and $4,003,000, respectively.

Fiscal 1978 amounts include a foreign company (not material) acquired during the year for $5,243,000, including cost in excess of net assets acquired of $3,161,000, which is being amortized over 20 years.

Pending Legal Proceedings

In December 1972 the Federal Trade Commission (FTC) filed a complaint alleging a violation of Section 7 of the Clayton Act in connection with Heublein's 1969 acquisition of an 82% interest in United Vintners, Inc., a California winery. In November 1976, the FTC issued an amended complaint naming as additional parties Allied Grape Growers (Allied), United Vintners and Heublein Allied Vintners. This complaint, as amended, is also based on Heublein's acquisition of a majority interest in United Vintners. It charges that, as a result of the acquisition, Heublein and Heublein Allied Vintners have violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act, and that United Vintners and Allied Grape Growers have violated Section 5. In the event FTC counsel are successful in proving a violation of Section 7, they are expected to seek an order requiring divestiture of Heublein's interest in United Vintners and prohibiting for ten years the acquisition of other companies producing or selling domestic wine. The trial of this case started in December 1977, and is expected to continue until late 1978. It is not known when a final decision will be reached. Management intends to continue to assert a vigorous defense of the FTC's allegations and believes that the outcome will not have a material adverse effect on the financial condition of Heublein.

In March 1975 Allied and eight members of its executive committee filed a complaint in Federal Court in San Francisco against Heublein and certain past and present officers of Heublein and United Vintners, alleging misrepresentation in violation of Federal securities laws and the laws of the State of California in connection with Heublein's acquisition of an 82% interest in United Vintners from Allied. In December 1975 Heublein and United Vintners filed counterclaims against Allied and certain of its directors in which they sought a judgment declaring that the grape supply contract executed by Heublein, United Vintners, and Allied in 1969 was illegal and unenforceable under the antitrust laws, and alleged that the plaintiffs and others who were not parties to the action illegally conspired in violation of the antitrust laws to raise the prices which Heublein and United Vintners paid for grapes. The counterclaims were tried along with Allied's suit during the Spring of 1978. The Court held that the grape supply contract was null, void and unenforceable. The Court also held that Allied was not entitled to recision of the sale of 82% of United to Heublein. Most of the rest of the claims

were not decided because the jury was unable to reach a unanimous verdict. On August 22, 1978, Heublein, United Vintners and Allied entered into an agreement which settled all litigation among the parties, and provided that there would be no appeals from the Court's decision in the litigation described above. Allied also agreed to sell to Heublein its remaining 18% interest in United Vintners, thus giving Heublein 100% ownership. Finally, Heublein, United and Allied agreed to a six-year grape supply contract.

Subject to judicial approval, settlement agreements have been reached with the plaintiffs by the Company and over 35 other defendants in a group of purported class action complaints related to the production and sale of broiler chickens. The estimated amount of the Company's settlement was provided in fiscal 1977 in connection with the disposition of its poultry operations.

Heublein and its subsidiaries are defendants in various other litigation matters in which aggregate alleged damages are substantial. Based upon the advice of counsel, management believes Heublein and its subsidiaries have adequate defenses and no material liability will result from such litigation.

Supplementary Income Statement Information

	1978	1977
	(In thousands)	
Taxes, other than income taxes:		
Federal, state and foreign excise taxes	$430,289	$400,500
Other	23,427	22,022
	$453,716	$422,522
Advertising, merchandising and sales promotion	$140,160	$136,264
Depreciation and amortization	$ 27,020	$ 23,714
Maintenance and repairs	$ 18,608	$ 18,437

The amounts are based on continuing operations. See "Leases" for information on rental expense.

Selected Quarterly Financial Data (Unaudited)

The following is a summary of selected unaudited quarterly financial data for the years ended June 30, 1978 and 1977 (in thousands except per share data):

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	1978	1977	1978	1977	1978	1977	1978	1977
Net sales	$376,337	$378,534	$433,270	$400,618	$362,108	$346,889	$405,399	$385,147
Franchise and license fees	11,779	11,060	10,492	9,446	9,107	8,465	11,620	10,743
Total revenues	388,116	389,594	443,762	410,064	371,215	355,354	417,019	395,890
Cost of sales	273,070	266,753	311,420	288,199	258,656	252,598	289,724	286,050
Net income	14,455	13,298	16,838	14,069	11,050	7,293	14,186	6,908
Earnings per share:								
Primary	.68	.62	.79	.65	.52	.34	.67	.33
Fully diluted	.66	.60	.77	.64	.51	.34	.65	.33

1977's first quarter net included a charge of $7,200,000; $.33 per primary share ($.31 per fully diluted share) for the first quarter loss ($520,000) and the disposal of the Company's poultry operations ($6,680,000). (See "Discontinued Operations".)

The 1977 fourth quarter included charges of approximately $3,000,000, net of tax benefit; $.14 per primary share ($.13 per fully diluted share) for the phasing-out of the equipment and supplies operation of Kentucky Fried Chicken.

Replacement Cost Information (Unaudited)

As required by the Securities and Exchange Commission, the Company's financial statements included in its Annual Report on Form 10-K contain unaudited replacement cost information. This information indicates that the replacement cost of the Company's inventories and productive capacity exceed the amounts originally incurred to acquire such assets, and that accumulated depreciation and depreciation expense based on average current replacement cost of productive capacity also exceed comparable amounts calculated using historical costs. Replacement cost of sales are approximately the same as historical cost of sales.

The replacement cost information in the Form 10-K, a copy of which is available on request, is based on many theoretical assumptions and substantial subjective judgments which may be subject to errors of estimation and management makes no representation that the replacement cost information is useful.

Report of Certified Public Accountants

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N.Y. 10017

Board of Directors and Shareholders
Heublein, Inc.

We have examined the accompanying consolidated balance sheet of Heublein, Inc. at June 30, 1978 and 1977, and the related consolidated statements of income, additional paid-in capital, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Heublein, Inc. at June 30, 1978 and 1977, and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

July 24, 1978, except as to the second paragraph of Pending Legal Proceedings as to which the date is August 18, 1978.

Management's Discussion and Analysis of Consolidated Summary of Operations

The following discussion is presented to explain certain comparative changes shown in the Consolidated Summary of Operations. The Company's accounting policies, consolidated financial statements, and notes to consolidated financial statements should be read in conjunction with this discussion since they are all essential in evaluating the Company's results of operations.

1978 Compared to 1977

Revenues increased 4% over the prior year. The Beverage Group was up 10% due to excellent demand for established products and the International Group advanced 21% due to sharp increases in offshore KFC operations as well as notable improvement in the Brazilian distilling operation. Food revenues declined 13% due principally to the phase-out of the equipment and supplies operation and a reduction in the number of company-owned stores. Management estimates that price increases amounted to 2% of revenues but this is heavily weighted by International's sharp price increases in Brazil due to their high inflation rate.

Cost of sales rose 4% due principally to increased volume, coupled with higher grape costs and packaging supplies, but partially offset by lower costs of paper and other food in the retail business.

Selling, advertising, administrative and general expenses were up 5%. Contributing to the overall increase were costs related to the conversion to point of sale registers at our KFC stores, increased advertising expenditures and higher legal fees in connection with the Allied and FTC suits.

Interest expense on short-term debt was lower by 43% due principally to improved management of our working capital needs in Brazil and somewhat lower rates of interest in that country.

Interest income was up 72% due to an increase in funds available for short-term investment and to somewhat higher interest rates.

Miscellaneous — net was unfavorable compared to the prior year. Foreign exchange gains were higher last year and capital gains from the franchising of certain KFC company-owned stores were realized in the prior year. This year we experienced capital losses on certain asset dispositions and began a program in Brazil of allowing discounts to customers for early remittance.

The decline in the tax rate to 48.5% from 49.4% in the prior year is due principally to higher foreign earnings with lower effective rates thereon.

1977 Compared to 1976

During 1977 management concluded that the Company would dispose of its poultry operations and a provision was made in the first quarter of fiscal 1977 to cover subsequent operating losses and disposal costs. See note under "Discontinued Operations". The discussion below compares continuing operations only and does not include any impact from poultry operations.

Revenues from continuing operations declined 2% from the prior year. The Beverage Group decreased 2% primarily due to lower sales volume in the refreshment wine category. The Food Group remained flat as a result of declines in Company-owned KFC stores offset by gains in Grocery Products' Mexican Food category and A.1. Steak Sauce. The contributing factors to KFC's decline were the refranchising program and lower per store averages, further complicated by 1977's severe winter conditions. The International Group fell 4% chiefly due to a decline in Brazilian beverage operations. Price increases were negligible.

Cost of sales declined only 1%, however. The decline in manufacturing costs due to lower volume paralleled the decline in sales but this was more than offset by higher costs of paper products, packaging materials, food costs and labor as well as a portion of the costs attributable to the phase-out of the equipment and supplies operation.

Selling, advertising, administrative and general expenses were unchanged. This is a result of reductions in advertising, merchandising and sales promotion of 3% (following a 22% increase in the prior year) and favorable cost controls with respect to general and administrative expenses resulting in a decline of 3% (7% before the negative impact of a portion of the equipment and supplies phase-out expenses). Offsetting these improvements, retail store operations spending increased because of KFC's quality service campaign and higher repairs and maintenance in an effort to enhance store image.

Interest expense rose 60% over the prior year as a result of the extremely high rates encountered in Brazil coupled with somewhat higher borrowings. Miscellaneous income was favorably impacted by greater foreign exchange gains.

The effective tax rate of 49.4% did not change from prior year, although the components of it did change.

Consolidated Summary of Operations

Dollars in thousands except per share data	1978	1977
REVENUES:		
Beverage	$ 923,847	$ 838,520
Food	423,742	487,245
International	272,523	225,137
	1,620,112	1,550,902
Cost of sales	1,132,870	1,093,600
Selling, advertising, administrative and general expenses	354,014	338,042
Operating income	$ 133,228	$ 119,260
OPERATING INCOME:		
Beverage	$ 80,450	$ 72,935
Food	32,918	30,777
International	19,860	15,548
	133,228	119,260
Interest expense	22,368	29,551
Interest income	4,690	2,726
Miscellaneous income (expense) — net	(5,785)	3,861
Income taxes	53,236	47,528
Income from continuing operations	56,529	48,768
Income (loss) from discontinued operations, less tax effect	—	(7,200)
Income before extraordinary items	56,529	41,568
Extraordinary items, less tax effect	—	—
NET INCOME	56,529	41,568
Preferred dividends	—	—
Earnings applicable to common stock	$ 56,529	$ 41,568
Common and common equivalent shares	21,251,335	21,435,418
Earnings per common and common equivalent share:		
Continuing operations	$2.66	$2.28
Discontinued operations	—	(.34)
Before extraordinary items	2.66	1.94
Extraordinary items	—	—
NET EARNINGS	$2.66	$1.94
Earnings per common share assuming full dilution:		
Continuing operations	$2.59	$2.23
Discontinued operations	—	(.31)
Before extraordinary items	2.59	1.92
Extraordinary items	—	—
NET EARNINGS	$2.59	$1.92
Dividends declared per common share	$ 1.38	$ 1.29
Common dividends declared	29,269	27,333
Earnings retained in the business*	27,260	21,435
Taxes of all kinds*	506,952	470,050
Capital expenditures	68,931	55,819
Depreciation and amortization*	27,020	23,714
Net property, plant and equipment	293,990	264,988
Working capital	238,387	235,339
Current ratio	2.1 to 1	2.1 to 1
Return on shareholders' equity*	14.1%	12.8%
Income as a percent of revenues*	3.49%	3.14%
Worldwide employment	22,817	22,789
Common shareholders	28,247	29,071

Restated where material
*Based on continuing operations

Heublein

1976	1975	1974	1973	1972	1971	1970	1969
$ 858,706	$ 772,576	$ 697,018	$ 586,423	$ 507,125	$ 446,343	$ 398,267	$ 358,081
489,302	446,792	387,272	315,096	273,154	229,309	222,020	189,909
235,125	195,047	155,852	64,620	33,721	19,984	15,751	6,051
1,583,133	1,414,415	1,240,142	966,139	814,000	695,636	636,038	554,041
1,099,416	988,474	855,134	660,173	546,674	470,739	429,596	390,309
338,454	290,151	265,660	211,523	181,185	155,866	138,096	105,267
$ 145,263	$ 135,790	$ 119,348	$ 94,443	$ 86,141	$ 69,031	$ 68,346	$ 58,465
$ 72,732	$ 63,226	$ 52,044	$ 42,005	$ 39,080	$ 32,491	$ 29,484	$ 26,473
52,211	55,985	51,458	45,170	43,456	34,120	36,178	30,449
20,320	16,579	15,846	7,268	3,605	2,420	2,684	1,543
145,263	135,790	119,348	94,443	86,141	69,031	68,346	58,465
18,494	16,910	9,830	6,357	7,381	8,321	8,930	3,315
2,810	2,147	1,384	1,683	646	396	1,295	274
763	632	122	(225)	367	(485)	1,409	765
64,433	61,661	58,683	46,877	41,474	31,834	33,207	30,544
65,909	59,998	52,341	42,667	38,299	28,787	28,913	25,645
7,184	1,498	2,069	1,544	(607)	396	2,729	5,900
73,093	61,496	54,410	44,211	37,692	29,183	31,642	31,545
—	—	—	(13,800)	(15,250)	(6,865)	283	—
73,093	61,496	54,410	30,411	22,442	22,318	31,925	31,545
—	—	—	—	293	1,078	1,377	2,733
$ 73,093	$ 61,496	$ 54,410	$ 30,411	$ 22,149	$ 21,240	$ 30,548	$ 28,812
21,536,526	21,216,540	21,166,002	20,932,055	19,607,538	18,522,645	18,036,939	17,683,913
$3.06	$2.83	$2.47	$2.04	$1.94	$1.50	$1.53	$1.30
.33	.07	.10	.07	(.03)	.02	.16	.33
3.39	2.90	2.57	2.11	1.91	1.52	1.69	1.63
—	—	—	(.66)	(.78)	(.37)	.01	—
$3.39	$2.90	$2.57	$1.45	$1.13	$1.15	$1.70	$1.63
$2.96	$2.72	$2.40	$1.99	$1.87	$1.44	$1.46	$1.26
.31	.07	.09	.07	(.03)	.02	.13	.30
3.27	2.79	2.49	2.06	1.84	1.46	1.59	1.56
—	—	—	(.61)	(.73)	(.33)	.01	—
$3.27	$2.79	$2.49	$1.45	$1.11	$1.13	$1.60	$1.56
$ 1.175	$ 1.075	$ .98	$ .91	$ .87	$ .84	$ .79	$ .74
24,838	22,711	20,497	18,095	15,921	9,554	8,586	7,774
41,071	37,287	31,844	24,572	22,085	18,155	18,950	15,138
486,366	452,976	421,249	341,247	292,349	250,990	236,235	212,049
52,223	55,634	59,259	38,954	30,325	45,086	69,365	34,679
20,778	18,730	14,919	10,750	10,267	9,458	9,655	6,461
254,558	225,870	189,880	148,858	149,052	153,564	155,880	111,840
230,344	219,535	212,800	124,800	147,530	77,035	83,172	47,786
2.0 to 1	2.1 to 1	2.2 to 1	1.8 to 1	2.4 to 1	1.6 to 1	1.7 to 1	1.4 to 1
18.9%	19.6%	19.3%	17.8%	18.8%	17.0%	18.8%	17.5%
4.16%	4.24%	4.22%	4.42%	4.71%	4.14%	4.55%	4.63%
24,871	25,912	24,711	18,300	17,452	16,794	15,693	13,754
24,769	27,174	27,493	28,537	30,044	33,426	29,626	29,586

Directors

EDWARD B. BATES
Chairman, Connecticut Mutual Life Insurance Company

CHRISTOPHER W. CARRIUOLO
Executive Vice President

JAMES F. ENGLISH, JR.
Vice President, Trinity College, and Chairman of the Board, The Connecticut Bank and Trust Company

EDWARD H. HAMM
Vice President, The Northland Company (A financial service company)

LEON W. HARMAN
President, Harman Management Corporation (A franchisee for quick-service restaurants)

RALPH A. HART
Consultant and Retired Chairman Heublein Inc.

CHARLES G. KLOCK
Retired President, General Electric Credit Corporation

JOHN G. MARTIN
Consultant and Retired Chairman Heublein Inc.

ARTHUR A. MILLIGAN
President, Bank of A. Levy

WILLIAM H. MORTENSEN
Personal Investments

ROBERT L. TRESCHER
Partner, Law Firm of Montgomery, McCracken, Walker & Rhoads

HICKS B. WALDRON
President

STUART D. WATSON
Chairman

Corporate Officers

STUART D. WATSON
Chairman

HICKS B. WALDRON
President

CHRISTOPHER W. CARRIUOLO
Executive Vice President

GWAIN H. GILLESPIE
Senior Vice President - Finance

PAUL R. DOHL
Vice President - Group Executive Spirits Group

MICHAEL A. MILES
Vice President - Group Executive Food Service and Franchising Group

JOHN A. POWERS
Vice President - Group Executive Wines Group

BARRY M. ROWLES
Vice President - Group Executive International Group

ROBERT R. WEISS
Vice President - Group Executive Grocery Products Group

HUGH R. BEATH
Vice President and Treasurer

GEORGE CASPAR
Vice President, Secretary and General Counsel

GENE R. EHNEN
Vice President and Controller

RICHARD C. FARR
Vice President - Executive Management and Human Resources

CHARLES J. HERBERT
Vice President
President, Spirits Sales Division

JOSEPH M. McGARRY
Vice President
Communication and Public Affairs

JOHN J. MORAN
Vice President - Assistant to the Chairman

ROY E. STONE
Vice President - Technical Resources

JAMES H. WILLE
Vice President
President, KFC Corporation

Committees of the Board

THE EXECUTIVE COMMITTEE exercises all powers of the Board of Directors during intervals between Board meetings and acts as an advisory body to the Board by reviewing in appropriate depth and detail all matters prior to their submission to the Board.

MEMBERS: **S.D. WATSON*, E.B. BATES, J.F. ENGLISH, JR., C.G. KLOCK, J.G. MARTIN, R.L. TRESCHER, H.B. WALDRON**

THE AUDIT COMMITTEE, composed entirely of outside directors, meets at least three times a year (separately and jointly) with the Company's independent public accountants, representatives of management and the internal auditors to review the internal and external financial reporting, internal controls and the scopes, audit plans and reports of both the independent public accountants and the internal audit staff. The Audit Committee also recommends the selection of the independent public accountants.

MEMBERS: **A.A. MILLIGAN*, C.G. KLOCK, R.L. TRESCHER**

THE COMPENSATION AND BENEFITS COMMITTEE is comprised entirely of non-employee directors and is responsible for reviewing employee benefit plans, administering the Company's Stock Option Plan, establishing the direct remuneration for all officers and directors, and determining distributions under the Company's bonus plan.

MEMBERS: **J.G. MARTIN*, E.B. BATES, J.F. ENGLISH, JR., C.G. KLOCK, R.L. TRESCHER**

THE FINANCE COMMITTEE reviews and appraises the Company's capital structure, its source and use of funds, and its financial position. The Finance Committee will make periodic reports to the Executive Committee and the Board of Directors on such reviews and will provide advice and counsel to management, the Executive Committee and the Board in the area of financial policy.

MEMBERS: **C.G. KLOCK*, E.B. BATES, J.F. ENGLISH, JR., H.B. WALDRON, S.D. WATSON**

THE NOMINATING COMMITTEE determines criteria for selection and qualifications desirable in Board members, evaluates possible candidates to serve on the Board, and aids in attracting qualified candidates to serve on the Board.

MEMBERS: **E.B. BATES*, J.F. ENGLISH, JR., J.G. MARTIN**

THE SOCIAL RESPONSIBILITY COMMITTEE reviews major social issues pertinent to the Company and assesses management's response to them. It reviews the Company's support of public sector activities and evaluates its effect on its employees, the public and the natural environment.

MEMBERS: **C.W. CARRIUOLO*, E.H. HAMM, L.W. HARMAN, R.L. TRESCHER**

*Chairman of Committee

Principal Offices

Corporate Headquarters
Farmington, Connecticut 06032 — (203) 677-4061

Food Service and Franchising Group Headquarters
1441 Gardiner Lane, Louisville, Kentucky 40232 —
(502) 459-8600

Kentucky Fried Chicken
Zantigo Mexican-American Restaurants
H. Salt Seafood Restaurants

Grocery Products Group Headquarters
900 Asylum Avenue, Hartford, Connecticut 06105 —
(203) 525-0171

International Group Headquarters
Farmington, Connecticut 06032 — (203) 677-4061

Spirits Group Headquarters
330 New Park Avenue, Hartford, Connecticut 06101 —
(203) 233-7531

Arrow Sales Company
Smirnoff Sales Company
Venture Sales Company

Wines Group Headquarters
601 Fourth Street, San Francisco, California 94107 —
(414) 777-6500

United Vintners, Inc.

Transfer Agents

The Bank of New York
90 Washington Street, New York, New York 10015

Bank of America, N.T. & S.A.
55 Hawthorne Street, San Francisco, California 94105

Registrars

Morgan Guaranty Trust Company of New York
30 West Broadway, New York, New York 10015

Wells Fargo Bank, N.A.
P.O. Box 44011, San Francisco, California 94120

Trustees

4½% Convertible Subordinated Debentures

United States Trust Company of New York
45 Wall Street, New York, New York 10005

8⅜% Notes

Morgan Guaranty Trust Company of New York
23 Wall Street, New York, New York 10015

Annual Shareholders' Meeting

The annual meeting of shareholders of Heublein Inc. will be held at 10:00 a.m. Thursday, October 26, 1978, in the Grand Ballroom of The Hartford Hilton, Ford and Pearl Streets, Hartford, Connecticut.
Shareholders may submit candidates for consideration as nominees for the Board of Directors to the Nominating Committee. The Committee considers each candidate and makes recommendations to the full Board. Members of the Committee are identified on page 48.

Heublein's 1978 Annual Report on Form 10-K as filed with the Securities and Exchange Commission will be available upon request from the Corporate Secretary, Heublein Inc., Farmington, Connecticut 06032.

Dividends Declared & Stock Price Ranges

			Stock Price Range*	
	Quarter	Dividend	High	Low
1978	4	$.35	30⅛	25⅛
	3	.35	28	23¾
	2	.35	27⅛	22⅝
	1	.33	25⅜	22
1977	4	$.33	26⅞	22¾
	3	.33	42⅞	26
	2	.33	48⅜	38¾
	1	.30	53	47¼

*New York Stock Exchange

Heublein Brands of Foods and Beverages

Listed below are the principal brands of fine foods and beverages marketed by Heublein. When you have occasion to use products of this type, we invite you to order Heublein brands by name — you'll be getting the finest products of their kind.

SPIRITS: Smirnoff Vodkas (80° & 100°) • Smirnoff Silver • Black Velvet Canadian Whisky • Black & White Scotch • Arrow Cordials and Brandies • Bahia Licor de Cafe • Heublein Cocktails • The Club Cocktails • Jose Cuervo Tequila • Cuervo 1800 • Don Q Rum • Irish Mist Liqueur • Milshire Gin • Tullamore Dew Irish Whiskey • Popov Vodka • Relska Vodka • Arrow Ostrova Vodka • McMaster's Scotch and Canadian Whiskies • Matador Tequila • Malcolm Hereford's Cows • Yukon Jack Canadian Liqueur • Boggs Cranberry Liqueur

CALIFORNIA WINES: Beaulieu Vineyard Wines • Inglenook Vineyards Wines • Italian Swiss Colony Table Wines, Dessert Wines and Apertifs • Petri Wines • Colony Varietal Table Wines • Annie Green Springs Refreshment Wines • T.J. Swann Refreshment Wines • Bali Hai Tropical Flavored Wine • Sangrole • Mission Bell Wines • Santa Fe Dessert Wines • H.M.S. Frost • Esprit • Jacare • G & D Wines and Vermouth • Lejon Champagne and Brandy • Jacques Bonet Champagne and Brandy • Zazie Refreshment Wine

IMPORTED WINES: Lancers Vin Rose, Vinho Branco and Rubeo • Harveys Bristol Cream • Bouchard Pere & Fils Burgundy • Egri Bikaver Hungarian Wine • Tokaji Aszu Hungarian Dessert Wine • Harveys Other Sherries and Ports • Vinya Rose • Kiku Masamune Sake • Taru Sake

CONVENIENCE FOODS: Colonel Sanders' Recipe Kentucky Fried Chicken • Extra Crispy Chicken • Barbecue-Style Chicken • H. Salt Seafood • The Colonel's Little Bucket Desserts • Zantigo Mexican-American Foods

SAUCES AND SPECIALTY FOODS: A.1. Steak Sauce • Grey Poupon Mustard • Ortega Tacos, Chiles, Sauces and Mexican-style Foods • Snap-E-Tom Tomato Cocktail • Regina Wine Vinegars and Cooking Wines • Escoffier Sauces • Steak Supreme Sauce • Hart's Dinner Rolls, Muffins and Buttermilk Biscuits

HEUBLEIN INC. FARMINGTON CONNECTICUT 06032